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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D C 20548

CIVIL DIVISION

December 3, 1969

CNG-00558

Dear Mr. Ball

We have completed a review of the reasonableness of the allocation of selected administrative costs to parts A and B of the Medicare program by the Aetna Life Insurance Company (Aetna) for calendar year 1967 Under a cost-type contract with the Social Security Administration (SSA), Aetna acts as a carrier under part B of the program and as a fiscal intermediary under part A of the program At the time of our review, the Department of Health, Education, and Welfare (HEW) Audit Agency had not made its review of Aetna's calendar year 1967 administrative costs

In our opinion, certain administrative costs for (1) data processing, (2) executive compensation and related costs, and (3) certain other indirect costs had not been equitably allocated to the Medicare program In discussing the method of allocating administrative costs with Aetna officials, we suggested that a more equitable method be used to allocate such costs to the Medicare program Aetna agreed to revise its method of allocating costs and will reduce its allocation to the Medicare program for calendar year 1967 by about $135,000. We estimate that the changes in the methods of allocating administrative costs will result in future annual savings of about $132,000. Our findings are discussed in more detail in the following sections of this report

DATA PROCESSING COSTS

In our opinion, the costs allocated to the Medicare program from the cost center for group data processing exceeded the costs incurred in connection with the Medicare program This overallocation occurred because certain costs incurred in the Group Data Processing Department (GDPD), such as those for rental of electronic data processing equipment and employee fringe benefits, had been charged to other cost centers but were also considered as part of the costs of the group data processing cost center in determining the percentage of cost to be allocated to the Medicare program Since part of the costs charged to the other cost centers also had been allocated to the Medicare program, we believe that the total costs allocated to the program were excessive.

We brought this matter to the attention of Aetna officials, who agreed that the method of allocating group data processing costs to the Medicare program was inequitable and that a more equitable basis for allocating these costs was needed After giving further consideration

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to this matter, Aetna devised a new basis for allocating these costs by computing the ratio of the Medicare costs in the GDPD to the total costs of operating the department, after eliminating those costs which were not applicable to the group data processing cost center The new method would result in a reduction of about $107,000 in the amount of $282,000 previously allocated to the Medicare program for 1967 and should result in comparable savings in future years

We reviewed the revised method and agree that it is a more equitable method of allocating these costs to the Medicare program Aetna officials advised us that the cost to be allocated to the Medicare program would be adjusted in accordance with the revised method upon completion of the HEW Audit Agency's review of its calendar year 1967 administrative costs

EXECUTIVE COMPENSATION AND RELATED COSTS

In our opinion, the allocation made to the Medicare program for compensation and related costs of the chairman of the board, the president, and other senior officers was excessive in relation to the amount of time they devoted to Medicare activities

The compensation of Aetna executives was allocated to the Medicare program in the same proportion as the compensation of subordinate officers who reported directly to them Similarly, the salaries of the subordinate officers were generally allocated on the basis of the distribution of the salaries of employees reporting directly to them However, Aetna made exceptions to this general method of allocating costs when it considered other methods more equitable. One of these exceptions was the method used to allocate the salary and other expenses of a vice president who acted as Medicare coordinator.

The salary and related expenses of the Medicare coordinator were allocated to the program on the basis of the percentage of time he devoted to Medicare activities rather than on the basis of the distribution of the salaries of his subordinates as discussed above This basis of allocation was used because, as Medicare coordinator, the vice president spent proportionately more time on Medicare activities than did his subordinates Accordingly, Medicare was charged 63 percent of his salary although only 14 percent of the salaries of his immediate subordinates was charged to Medicare

We do not consider the method used to allocate the Medicare coordinator's salary unreasonable. However, Aetna used the 63-percent allocation of the Medicare coordinator's salary in determining the composite rate to be used for allocating the salaries of the chairman of the board, the president, and other senior officers to the Medicare program. As a result, the amount of the salaries and related costs of executives charged to the Medicare program appeared to be excessive in relation to the amount of time they devoted to the program.

We discussed this matter with Aetna officials, and they agreed to revise the method of allocating these costs retroactive to January 1, 1967 Under the revised method, Aetna allocated executive salaries to the Medicare program in the same ratio as it allocated such costs to group accident and health insurance lines of business, since it claimed that the amount of time devoted to both programs by these executives would be comparable This revised method, which we consider to be more equitable, will result in a reduction of about $22,000 in the amount allocated to the Medicare program for 1967. The revised method should result in comparable savings in future years Aetna officials advised us that the costs to be allocated to the Medicare program would be adjusted in accordance with the revised method upon completion of the HEW Audit Agency's review of its calendar year 1967 administrative costs

OTHER INDIRECT COSTS

During the course of our review, we also noted several minor elements of cost which, Aetna officials agreed, were improperly allocated to the Medicare program These items involved the manner in which employee pension costs and depreciation were computed and an overallocation of auditor travel expense and certain salary costs These items were discussed with Aetna officials who advised us that the administrative costs to be allocated to the Medicare program in 1967 would be reduced by about $6,000 upon completion of the HEW Audit Agency's review of its calendar year 1967 administrative costs. We estimate that about $3,000 of the $6,000 reduction should be realized annually in future years.

CONCLUSIONS

Since various committees and members of the Congress have expressed concern over the rising costs of medical care being charged to the Medicare program, we believe that there is a need for SSA to assure itself that only those costs which are properly allocable to the program are reimbursed to the carriers and intermediaries operating under the program. In keeping with this objective, we believe that SSA should take the action necessary to assure itself of the propriety of the allocation of costs of the types described in this report In this connection, we believe that SSA should request the HEW Audit Agency to pay particular attention to these types of costs in its future reviews We believe further that SSA should take the necessary follow-up action to determine that Aetna made the reductions in 1967 administrative costs as discussed in this report

RECOMMENDATIONS

We recommend that the Commissioner of Social Security take appropriate action to (1) assure that costs of the types discussed in this report are properly allocated to the Medicare program by other carriers and intermediaries and (2) determine that Aetna makes the agreed-upon reductions in the administrative costs charged to the Medicare program.

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Your comments on the matters discussed in this report and advice as to any action taken in connection with these matters would be appreciated.

Sincerely yours,

JOSEPH P. ROTHER, JR

Joseph P. Rother, Jr
Assistant Director

Mr. Robert M. Ball
Commissioner of Social Security
Department of Health, Education, and Welfare